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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

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CIA No. 8025
15 March 1974

[redacted]

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MEMORANDUM FOR: Lt. Col. John Gander
Office of the Secretary of Defense
Room 4C762
The Pentagon

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SUBJECT : Information on Iranian and Saudi Arabian Economic and Spending Outlook

[redacted]

1. In response to your telephone request today, I am forwarding some quickly-prepared comments on the economic and spending outlook for Iran and Saudi Arabia. [redacted]

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Attachments:
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Distribution: (S-Project 6014)
1 - Addressee (LDX 15 Mar 74)

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TAB A

IRAN: ECONOMIC IMPLICATIONS OF EXPANDED OIL INCOME AND SPENDING

The sudden escalation in oil prices of 23 December 1973 brought about significant change in Iran's outlook for income and expenditure. Instead of a deficit and need for heavy borrowing, Iran suddenly faced the prospect of having revenues well in excess of its immediate needs and viable spending opportunities. Even with a recent proposed scale back in plans for oil output, it appears that Iran will earn some $60 billion more than it initially planned from oil during the five years ending 1978.

The Shah currently is trying to adjust to the new financial situation posed by unexpectedly large oil revenues. He apparently will revise overall developmental spending upwards by about $10 billion, promote a more rapid build up in defense, increase aid, and reduce the outstanding large debt. Even the full panoply of these spending measures, however, will probably not absorb the revenues likely to develop. Conceivably, therefore, the Shah will try to find additional areas for spending and investment or, alternatively, move to limit the growth in revenues from oil.

Within the context of currently planned expansion, Iran faces several difficulties. The rapid economic growth to date -- about 11% yearly since the mid-1960s -- has strained

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resources, left bottlenecks in transportation, equipment, technical services, and various industrial inputs. In turn, it has created a high and possibly serious inflationary situation. The Shah, therefore, is facing a delicate problem of wanting to expand rapidly and at the same time prevent more serious internal economic problems.

The course of Iranian expansion during the next several years will call for substantial purchases of materials and technical assistance from abroad. These purchases will include many items which the US has traditionally supplied as well as others which the US is in a good position to supply. Iranian needs for petrochemical facilities, iron and steel plants, electronics, power facilities, transport equipment, and various types of manufacturing are but a small indication of areas where the US can compete effectively. New areas in which Iran is thinking of developing, including nuclear power, also invite US sales efforts. The role of the US in these undertakings, however, is nowhere as secure from competition as it was previously when US credits were an essential for Iran. Now, the Shah is looking at all offers very carefully and is showing an increased interest in buying the technology in place in the US and transferring it to Iran.

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TAB B

SAUDI ARABIA: ITS ECONOMY AND ECONOMIC POLICY

Outside of the petroleum industry, the Saudi Arabian economy is significantly underdeveloped. Although agriculture and related pastoral activities support about one half of the 5 million population, they account for only a small proportion of GNP. Government services, handicraft industries, construction, commerce, and a nascent industrial sector are the other main economic activities, and together with agriculture probably will only account for about 15% of the estimated $23.5 billion GNP for 1974. Oil and gas are the only natural resources of merit to date, although there may be some exploitable mineral deposits. Outstanding deficiencies in domestic production are reflected in the pattern of imported goods. The principal imports are food, other consumer goods, construction materials, and industrial goods.

A major retardant to development has been a shortage of adequate manpower. This shortage is due to many factors, a significant one of which is the traditional Saudi distain for manual labor. Much of the potential labor force is ill-trained and, in some cases, ill-disposed to training. This is particularly true of the nomadic tribes, which are loath to change their traditional ways of living. The

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manpower shortage is compounded by the inefficient use of the existing labor force, both skilled and unskilled. Saudi Arabia relies increasingly on foreign workers, while at the same time imposing constraints on immigration.

Key economic policy priorities of the Saudi government have been to enhance oil revenues through oil production growth and to accelerate economic development spending. Industrial diversification beyond the oil sector, agricultural and water resources development, transportation and communications, and education and social and health services all have high priority. The government also is spending heavily in defense and security programs.

The rapid rise in Saudi oil revenues since 1971 has removed the income restraint on Saudi expenditures, but spending now is still limited by the Saudis' inability to develop reasonable projects. Government development spending regularly fails to exceed 60% of budgeted expenditures. With the changing situation the Saudis have not been able to meet even their relatively modest planned spending plans. A major factor has been a shortage of skilled workers and managers. But more importantly the idea that massive development spending was both possible and desirable has only recently taken hold.

The Saudis can increase their spending capability by concentrating on capital intensive industrial projects and by improving their defense capabilities. They cannot do this, however, without substantial help from the industrial west, especially the United States.

It is not possible that spending will approach rapidly rising oil revenues ($5.5 billion in 1973 and estimated $20 billion in 1974) because the country's absorptive capacity clearly is limited. Expenditures in 1974, for example, probably will not exceed $3.5 billion to $4 billion. Even under the most generous assumptions, spending will fall far short of revenues for several years.

Faysal is not opposed to change and development per se, but he intends to shape its pace and direction. He has spent lavishly in the development of ports, communications, and industrial projects, but he has a profound conviction that economic growth should not be bought at the expense of traditional religious values and the old ways. While the king is determined to bring Saudi Arabia's economy into the modern world at a deliberate pace, stability has been his first priority; he wants to avoid the social and political dislocation that he believes has so often occurred elsewhere in the Arab world.

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